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SUBJECT: TAIWAN'S MEMORY CHIP SECTOR FACING RESTRUCTURING

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Classified By: AIT Director Stephen M. Young, reasons 1.4 (b) and (d).

11. (C) Summary. Taiwan's DRAM manufacturers are in trouble. A combination of over-production, price drops beginning in 2007, and stagnant demand during most of 2008 has produced a serious liquidity problem. Two of the leading producers have looked to the Ma administration for relief. The stakes for Taiwan are significant. The DRAM industry employs 25,000 people, just under 50 percent of all employment in the chip production sector, and accounts for about 4 percent of Taiwan's total exports. Without some form of assistance, at least one of these companies could face bankruptcy next month, with potential implications for U.S. computer makers. Taiwan's banks have approximately NTD 70 billion (USD 2.1 billion) in loans to DRAM makers that will come due in 2009. Although officials publicly avow support for the DRAM industry, contacts tell us privately that restructuring the industry overall, to include consolidation and technology acquisition, is the administration's goal. Saving individual firms is not. End Summary

Overcapacity, Low Prices, Lower Demand

12. (C) Taiwan is the source of approximately 40 percent of the world's dynamic random access memory (DRAM) chips, the most common kind of memory for personal computers. The industry has been a vital component of Taiwan's economic growth over the last decade. Rising prices for DRAM chips since 2002 induced Taiwan's producers cumulatively to invest about NTD 850 billion (USD 25 billion) in new production capacity, following the global trend. According to Brian Shieh, President of Taiwan's Powerchip Semiconductor Corp. (PSC), in 2007 alone worldwide investment by DRAM manufacturers was approximately USD 25 billion, compared to total sales of approximately USD 35 billion. Shieh estimates the average ratio of capital expenditure to sales in 2007 was an extraordinarily high 70 percent or more. Normally this ration would be nearer 45 to 50 percent.

13. (SBU) The resulting expansion of output in Taiwan, combined with increased production in Korea, Japan and the U.S., led to a global oversupply of DRAM. Prices dropped significantly in 2006 and 2007. Despite limited price strengthening in the third quarter of 2008, Taiwan's DRAM manufacturers suffered serious losses last year. Through the first three quarters of 2008, PSC had lost approximately NTD 32 billion (USD 1 billion). Nanya Technology lost NTD 24.8 billion (USD 775 million). The third-largest producer on the island, Promos, lost about NTD 22.4 billion (USD 700 million).

14. (C) Taiwan manufacturers responded to the price fall by reducing production. For example, PSC Vice President Eric Tang told us recently that his firm has cut production by 20 percent, and will close down its facilities completely for an additional week for the Lunar New Year holiday period, effectively cutting production by 50 percent in January.

15. (SBU) Taiwan DRAM producers have also scaled back plans for investment in new capacity. PSC, which invested USD 2.17 billion in 2007, spent about USD 840 million in 2008. Similarly, Nanya and ProMOS reduced 2008 investment to less than half of 2007 levels, according to data compiled by the U.S.-Taiwan Business Council.

16. (C) Nonetheless, the cash flow crisis most of Taiwan's DRAM makers face is not likely to disappear in the near term. PSC's Tang told us the company estimates that the average price per chip will strengthen to around USD 1.5 by the second quarter of 2009, which will allow the company to realize a net cash inflow, although it will still be far from profitable. For ProMOS, the situation is more dire, since the company has approximately USD 300 million in convertible bonds due on February 14. If the company is not able to secure a significant infusion of capital, it may not be able to pay off the bonds and could face bankruptcy.

Official Commitment to Assist Industry, Not Firms

17. (C) President Ma Ying-jeou, Premier Liu Chao-shiuan, the Chairman of the Council on Economic Planning and Development (CEPD), Chen Tai-jy, and Economic Minister Yiin Chii-ming have all stated publicly that the administration will not allow Taiwan's DRAM industry to fail. Minister of State Chu Yun-peng recently told us the Ma administration will support the DRAM sector, with the overall goal of consolidation through the merger of smaller firms with larger ones to increase their competitiveness. CEPD's Chen told us (reftel) the administration wants to encourage strategic international alliances for Taiwan's DRAM companies, including a major consolidation, combining the advanced technology of foreign partners with Taiwan's strength in production capacity. Separately, though, CEPD Senior Economist Regina Chyn told us a bailout of the DRAM sector has not yet been finalized, noting that the Ma administration has been criticized by politicians, labor unions and the media for helping the high technology sector instead of traditional industries.

18. (SBU) On December 16, Ministry of Economic Affairs (MOEA) Vice Minister Shih Yen-shiang, who is overseeing official assistance to the industry, issued a press statement outlining the administration's position. Shih reiterated the importance of the DRAM industry to Taiwan's overall economy, and pledged official support. However, the key message conveyed in the statement is that the administration's principal objective is improving the competitiveness of the sector in the long term, not rescuing individual firms in the short term. This point has generally been overlooked by mainstream commentators and the media.

19. (C) Shih's statement identified the criteria MOEA would use to evaluate assistance proposals from DRAM makers. These are: facilitating development in Taiwan of chip production technology, increasing Taiwan's international competitiveness, and ensuring the most efficient use of taxpayer funds.

110. (C) Officials of MOEA's Industrial Development Bureau (IDB) told us recently that use of public sector capital to assist any DRAM manufacturers would require Legislative Yuan (LY) approval. Since the LY session ended on January 13, it seems that any assistance involving expenditure of government funds could not happen until the LY reconvenes in early to mid-February. In the absence of other forms of intervention, it is unclear whether the administration will allow a ProMOS

bankruptcy.

Manufacturers Seeking Bailout

¶11. (SBU) Both PSC and ProMOS submitted proposals to MOEA for assistance to deal with their current cash flow shortage. While MOEA officials declined to reveal any details of the proposals, they told us recently that media reports that MOEA had "rejected" the PSC and ProMOS proposals were inaccurate. According to these officials, MOEA merely "returned" the proposals to the respective firms with a request for additional information on how each would actually contribute to improving the competitiveness of Taiwan's DRAM industry and securing the development of production technology on the island.

¶12. (C) PSC's Tang confirmed that MOEA had not approved his firm's proposal for assistance. He indicated that MOEA wanted to see "more details" about how PSC and its Japanese partner Elpida would jointly develop DRAM manufacturing technology in Taiwan. (Note: Under current practice, Taiwan's chip manufacturers lease this technology from their Japanese, Korean or U.S. partners. End Note.) According to Tang, MOEA wants industry to take the lead in crafting a restructuring plan, adding that the ministry is pressuring both PSC and Nanya to negotiate a merger with ProMOS. Tang said neither PSC nor Nanya (nor their foreign partners) are interested in such a deal, since no one wants to incur ProMOS's heavy debt. He claimed that PSC was no longer seeking official assistance and instead would sell certain assets to raise cash in the short term. However, media reports on December 10 quoted PSC Chairman Frank Huang urging Taiwan authorities to provide PSC NTD 10 billion (USD 303 million) in loans to help the firm deal with its liquidity problem.

¶13. (C) The head of the information technology section of IDB told us that PSC's proposal did not meet MOEA's criteria of enhancing Taiwan's competitiveness and facilitating on-island technology development. Later, on January 12, MOEA issued a press statement saying the proposal from ProMOS did not meet the ministry's strategic goals. According to the statement, MOEA will invite ProMOS, PSC and Rexchip (a joint venture between PSC and Elpida) to consult jointly with the ministry on alternatives for restructuring the sector.

Comment

14 (SBU) Solving the challenges facing Taiwan's DRAM sector could have major implications for Taiwan's banks. The failure of any one of the island's DRAM manufacturers could also disrupt the supply chains of U.S. manufacturers of notebook and desktop computers. It could also possibly affect U.S. firms such as Applied Materials and ASML, which manufacture chip production equipment. Media coverage of the ongoing bailout saga seems focused on the possibility of an infusion of government money into one or more of the suffering companies. Our conversations with administration officials, however, suggest that MOEA is reluctant to intercede directly to save any individual firm, and instead seeks a long-term restructuring that would better position Taiwan's DRAM industry to compete globally. End Comment.

SYOUNG